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RETIRE AT YOUR OWN RISK: ERISA'S RETURN ON INVESTMENT?

1974—The agony of years of frustrated and disappointed beneficiaries has now come to an end. The discipline of law will enable this and succeeding generations of workers to face their retirement period with greater confidence and greater security.¹

1993—[C]orporate America is losing its taste for the guaranteed pension. In its place, companies are moving to plans that leave workers responsible for paying part of the cost and managing their own investments—and raise the prospect that those who don't join up or who make poor choices will come up short in retirement.²

In 1974, in response to pension funding failures and misconduct by pension plan sponsors, Congress passed sweeping legislation to reform employee benefit plan formation and practices.³ This legislation, the Employee Retirement Income Security Act ("ERISA"),⁴ had among its main purposes to ensure that nongovernmental employees⁵ with employer-sponsored pension plans would receive promised pension funds.⁶

¹ Francis X. Lilly, *The Employee Retirement Income Security Act*, 35 LAB. L.J. 603, 604 (1984) (quoting Senator Javits, primary sponsor of Employee Retirement Income Security Act ("ERISA"), after its passage in 1974).

² Marc Levinson et al., *Retirements at Risk*, NEWSWEEK, Dec. 6, 1993, at 38.

³ See A.B.A. SECTION OF LABOR AND EMPLOYMENT LAW, EMPLOYEE BENEFITS LAW 16 (Steven J. Sacher et al. eds., 1991) [hereinafter EMPLOYEE BENEFITS] (commenting that almost one decade of studying private employer pension plan system preceded passage of ERISA); Andrew H. Chen & Hyosuk Kang, *Financial Implications of ERISA: Theory and Evidence*, 40 J. ECON. & BUS. 193, 193 (1988) (noting that passage of ERISA was major legislative development with great impact on private pensions).

⁴ Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001-1461 (1988)).

⁵ "Governmental plans" are excluded from coverage under Title I of ERISA. 29 U.S.C. § 1003(b)(1) (1988). The term "governmental plan" is defined at 29 U.S.C. § 1002(32) (1988).

⁶ See, e.g., EMPLOYEE BENEFITS, *supra* note 3, at 17; BARBARA J. COLEMAN, PRIMER ON EMPLOYEE RETIREMENT INCOME SECURITY ACT 3 (2d ed. 1987).

ERISA protects the interests of the plan participant or beneficiary by creating statutory enforcement rights. 29 U.S.C. § 1132(a) (1988 & Supp. V 1993). ERISA was also intended to regulate the formation and operation of plans, § 1001(b), (c), to provide the government with enforcement powers, § 1132(a), and to establish federal pension insurance for certain defined-benefit plans, §§ 1301-1323.

In many ways ERISA has been dramatically successful: employees are vested earlier, pension discrimination is significantly decreased, most pensions are adequately funded, and employees are more knowledgeable about the nature of their benefit plans.⁷ Since the passage of ERISA, however, there has been a discernible trend shifting the risk of accumulating sufficient retirement funds to the employee.⁸ This trend is manifested in a decreased reliance on employer-controlled defined-benefit plans and an increased usage of employee-controlled defined-contribution plans.⁹

Most private employer pension plans are covered under ERISA.¹⁰ Broadly defined, pension plans are of two types: defined-benefit plans and defined-contribution plans.¹¹ In general, a defined-benefit plan provides an employee with a specific benefit expressed as an amount payable to the employee upon retire-

⁷ These changes have all been statutorily required. See 29 U.S.C. §§ 1053-1055 (1988 & Supp. V 1993); I.R.C. § 411 (1988 & Supp. V 1993) (requiring pension plans to meet minimum standards for vesting of accrued benefits, based on employees' years of service, to qualify for favorable tax treatment); I.R.C. § 401(a)(4) (1988) (regulating discrimination in amount of benefits or contributions); 29 U.S.C. §§ 1081-1086 (1988) (establishing minimum funding standards for most private defined-benefit plans); I.R.C. § 412 (1988 & Supp. V 1993) (same); 29 U.S.C. § 1024(b)(4) (1988) (requiring plan administrator, upon written request, to provide plan participants and beneficiaries with plan documents); see also Leon E. Irish, *Twenty Years of Employee Benefits*, J. PENSION PLAN. & COMPLIANCE 1, 10-12 (1992) (discussing effects of ERISA).

⁸ See Levinson, *supra* note 2, at 38.

⁹ *DOL Report will Highlight Ongoing Shift in Pension Plans*, 20 Pens. & Ben. Rep. (BNA) 2023 (Sept. 27, 1993), available in LEXIS, Penben Library [hereinafter *DOL Report*] (citing Labor Department data indicating that between 1975 and 1990 number of participants in defined-contribution plans increased by over 300%, while number of participants in defined-benefit plans decreased).

¹⁰ See 29 U.S.C. § 1002(2)(A) (1988). "Pension plan" is defined as follows:

[A]ny plan, fund, or program which was heretofore or is hereinafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan or program—(i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

Id.; see *Hollingshead v. Burford Equip. Co.*, 747 F. Supp. 1421, 1427-28 (M.D. Ala. 1990) (holding that pension plans are covered under ERISA if acts that necessarily evidence intent to form or maintain plan to provide specific benefits are established); *EMPLOYEE BENEFITS*, *supra* note 3, at 19 (noting that ERISA generally covers all pension and welfare funds established for employees by employer).

¹¹ See, e.g., *In re DeFoe Shipbuilding Co.*, 639 F.2d 311, 313-14 (6th Cir. 1981) (holding that pension plan must be considered defined-benefit plan absent proof that it is defined-contribution plan).

ment.¹² The benefit to be paid is frequently based on the employee's years of service and a percentage of compensation,¹³ and may account for the employee's expected social security income.¹⁴ A defined-contribution plan provides for an individual account in which the actual benefit provided represents amounts contributed by the employee or employer, plus investment earnings gained thereon.¹⁵

Prior to the passage of ERISA, defined-benefit plans were the dominant form of pension coverage.¹⁶ After its enactment, however, the number of defined-contribution plans substantially increased, while the number of defined-benefit plans grew slightly or remained stagnant.¹⁷ This shift reflects a number of factors af-

¹² See COLEMAN, *supra* note 6, at 17 ("A defined pension benefit plan promises a fixed monthly benefit upon retirement."); see also Irish, *supra* note 7, at 15 (stating that defined-benefit plan pays pensioner fixed monthly benefit for life).

¹³ See 29 U.S.C. § 1002(35) (1988). ERISA interprets a defined-benefit plan as any plan that does not meet the statutory definition of a defined-contribution plan. *Id.*; see also COLEMAN, *supra* note 6, at 17-18. ERISA does not set forth the formulation of these factors necessary to determine the actual benefit. See *id.*

¹⁴ COLEMAN, *supra* note 6, at 34 ("In determining pension benefit or contribution levels, employers have been permitted by the Tax Code to take into account an employee's Social Security benefit. The employer is given credit in effect for Social Security taxes paid for each worker. This practice is called integration.").

¹⁵ See 29 U.S.C. § 1002(34) (1988).

The term "individual account plan" or "defined contribution plan" means a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

Id.; see also COLEMAN, *supra* note 6, at 18; EMPLOYEE BENEFITS, *supra* note 3, at 77-79. Defined-contribution plans include profit-sharing plans, which can have a discretionary amount as the employer's annual contribution; money purchase plans, which have a fixed annual contribution; employee stock ownership plans, under which the employer contributes to the employee account and then invests the funds in company stock; and savings and thrift plans such as individual retirement accounts and 401(k) plans, in which the employee defers a portion of his salary to be contributed to an account. *Id.* In most such plans, the funds will be transferred to the investments selected by the employee. *Id.*

¹⁶ See Irish, *supra* note 7, at 2-5 (noting that rising numbers of private pensions established before 1970 followed growth of labor movement, typically characterized by large defined-benefit pension plans); see also ROBERT L. CLARK ET AL., DECLINING USE OF DEFINED BENEFIT PLANS: IS FEDERAL REGULATION THE REASON? 1-2 (N. C. State Univ., Dep't of Economics and Business, Faculty Working Paper No. 119, Apr. 1988) (noting that prior to 1974 most workers with pension coverage were covered by defined-benefit plans).

¹⁷ See Stephen H. Miller, *Future of Employee Benefits Debated*, J. Acct., May 1994, at 20 (examining potential demise of defined-benefit plans and projected reliance on defined-contribution plans); DOL Report, *supra* note 9; Curtis Vosti, *Panacea*

fecting the relative attractiveness of these two types of pension plans, including changes in the employment landscape, increasing regulation, and differences in the maintenance costs of the plans.¹⁸ The practical effect of this trend is to shift the burden of providing adequate retirement income from the employer to the employee.¹⁹

This Note examines the history and legislative intent underlying ERISA, the driving forces behind the trend toward defined-contribution plans, and the potential problems this trend creates for employees. It then examines the employer's fiduciary duty and potential liability to employees covered by a defined-contribution plan. Finally, it suggests some possible avenues for restoring the protections originally intended as part of ERISA.

I. HISTORICAL BACKGROUND OF ERISA

Prior to the enactment of ERISA, the regulation of private pension plans was left mostly to employers,²⁰ with the federal gov-

or Problem Child; Questions Surround Popular Defined Contribution Plans, PENSIONS & INVESTMENTS, Apr. 1, 1991, at 23 (stating that defined-contribution plans "have grown in recent years to become the focal point of employee benefit activity").

¹⁸ See *infra* notes 39-93 and accompanying text.

¹⁹ See Michael Tackett & Christopher Drew, *Pension Funds Become Bonanza for Companies*, CHI. TRIB., Dec. 4, 1989, at 1.

The difference [between defined-benefit and defined-contribution plans] is important. Nearly two-thirds of the companies that terminated pension plans started new retirement plans in the form of defined-contribution plans instead of defined-benefit plans, the primary form of pension benefits for more than a century.

In a defined-benefit plan, a company promises to pay an employee a certain amount of money for life when he or she retires. The company bears the risk, and if the pension fund fails, the plans are guaranteed by the government through the pension board.

In a defined-contribution plan, the company promises to put a certain amount of money or stock in an account that the employee claims at retirement in a lump sum.

Some of the risk of investment is shifted to the employee.

It may provide more money or stock for people immediately upon retirement, but there is no government safety net for defined-contribution plans and little recourse for someone working for a company that fails.

Id.

²⁰ See EMPLOYEE BENEFITS, *supra* note 3, at 2. Prior to the 1947 passage of the Labor Management Relations (Taft-Hartley) Act, 29 U.S.C. §§ 141-87 (1988), legislative involvement with private pensions was limited to tax incentives and qualifications. *Id.* at 2-3. The Taft-Hartley Act, and the 1962 Welfare and Pensions Plans Disclosure Act ("WPPDA"), Pub. L. No. 85-836, 72 Stat. 997 (1958) (codified at 29 U.S.C. §§ 301-309 (1988)) (repealed by ERISA 1974), required pension plans to have joint trustees representing management and labor. The laws required these trustees to re-

ernment's involvement effectively limited to tax considerations.²¹ As a result, employees were left with little protection or recourse if a pension plan failed to provide a promised benefit.²² This lack of security was one of the driving forces behind the development of ERISA, along with legislative concern regarding the adequacy of retirement income.²³

ERISA developed at a time when the American workforce had shifted from an industrialized job base to a post-industrial job base,²⁴ and when private pensions had become extremely common.²⁵ Prior to ERISA, the industrialized workforce, character-

port to the Department of Labor, but the statutes did not provide effective protection or remedies for the employee. *EMPLOYEE BENEFITS*, *supra* note 3, at 4-5.

²¹ See *COLEMAN*, *supra* note 6, at xi. Most of the pension regulation before the passage of ERISA resulted from Internal Revenue Service rules, which allowed business expense deductions for contributions to tax-qualified plans. *Id.* Under these rules, tax-qualified plans were those that provided pension benefits for some employees, typically highly paid executives and officers. *Id.*

See also *Irish*, *supra* note 7, at 2. During and after World War II, high tax rates associated with the war led employers to make greater contributions to qualified pension plans to receive the benefit of tax deductions. *Id.* At the same time, however, the tax qualifications became stricter. *Id.*

²² See H.R. REP. NO. 533, 93d Cong., 2d Sess. 5 (1974), *reprinted in* 1974 U.S.C.A.N. 4639, 4643 (noting that employees were forced to rely on common law of trusts to protect pensions and they could lose all or part of their benefits within days of retirement, thus creating need for legislative reform).

²³ See *EMPLOYEE BENEFITS*, *supra* note 3, at lxvii (noting that two-thirds of Senate and House Labor Committee members were from industrialized states with older, declining industries and large unions, and that their chief concern was protecting their constituents' retirement benefits).

²⁴ See generally *ROBERT J. LYNN, THE PENSION CRISIS 26-27 (1983).*

A majority of employed Americans are now classified as *white collar* workers. The upsurge in white collar work is attributable principally to greatly increased numbers of people in *services* (health care, insurance, banking, finance, government, transportation, and hotel and restaurant work). *Blue collar* employment is a proportionately less significant part of total employment than it was at the close of World War II, and its relative significance continues to decline.

Id. at 26-27; see *BUREAU OF LABOR STATISTICS, U.S. DEP'T. OF LABOR, LABOR FORCE STATISTICS DERIVED FROM THE CURRENT POPULATION SURVEY, 1948-87, 383-94 (1988)* [hereinafter *LABOR FORCE STATISTICS*]. The statistics indicate that the average number of private wage and salary workers in finance, insurance, real estate, and other services increased approximately 150% to 200% annually between 1948 and 1974, while the average number of private wage and salary workers in manufacturing and goods production increased 15% to 30% annually during the same time period. *Id.*

²⁵ See *ROBERT L. CLARK & ANN A. McDERMED, THE CHOICE OF PENSION PLANS IN A CHANGING REGULATORY ENVIRONMENT 66 (1990)* (citing U.S. Bureau of Labor Statistics report showing increase in pension coverage among private nonagricultural workers from 4.1 million in 1940 to 18.7 million in 1960, a trend that continued over following 15 years). The growth of private pensions after World War II is at least partly

ized by large labor unions with defined-benefit pension plans, lobbied for increased security for their members with pension coverage.²⁶ This same group had lobbied for increases in the retirement income provided by social security.²⁷ Not coincidentally, at approximately the time Congress enacted ERISA, social security benefits were greatly increased.²⁸ Increased social security was intended to provide a floor for retirement income and was to be supplemented by pension income. The proponents of ERISA envisioned retirement income as a "three-legged stool" supported by pension income, social security, and personal savings.²⁹

The broad objective of ERISA, as its name suggests, is the financial security of retired employees.³⁰ Specifically, ERISA has four primary goals:³¹ to protect the interests of pension plan par-

attributable to employers' use of pensions to defer compensation, to avoid the price fixing of that period, and to obtain tax deductions. *Id.* at 70-72. In addition, unionized labor, which grew dramatically in the years after the depression, was successful in establishing pensions as a subject for collective bargaining under the Taft-Hartley Act of 1947. *Id.* at 71; *see also* Irish, *supra* note 7, at 2 (noting that private pension coverage rose from 10% of all private wage earners in 1930s to 42% of private wage earners in 1970).

²⁶ *See* David Langer, *Protector Becomes the Threat to Pensions*, PENSIONS & INVESTMENTS, Sept. 14, 1992, at 15. In 1964 two large unions in particular, the United Auto Workers and the United Steelworkers of America, began lobbying heavily for federal pension insurance. *Id.* at 16. Both unions represented weakening industries and members with depleted or at-risk pension benefits. *Id.*

²⁷ *See* W. ANDREW ACHENBAUM, SOCIAL SECURITY: VISIONS AND REVISIONS, 40-47 (1986) (noting that labor unions understood value of social security to their constituencies and consistently supported amendments that would increase these benefits).

²⁸ *See* Social Security Amendments Act of 1972, Pub. L. No. 92-336, 86 Stat. 406 (codified as amended in scattered sections of 42 U.S.C.) (raising social security benefits by 20% and establishing automatic cost of living adjustments for inflation).

²⁹ *See* LYNN, *supra* note 24, at 41 ("Conventional wisdom holds that ideally, retirement income should originate in three sources: social security, private pension plans, and private savings (the three legged stool)."); Irish, *supra* note 7, at 6 ("Social Security provides minimum benefits for all workers . . . Private pension plans supplement Social Security, at least for those who have meaningful coverage under them. The third leg of the stool is private savings.").

³⁰ *See* 29 U.S.C. § 1001(a) (1988). Congress noted that despite the growth in private pensions, "many employees with long years of employment are losing anticipated retirement benefits," and that it was "desirable in the interests of employees and their beneficiaries" that minimum standards be provided to insure the integrity and stability of employee benefit plans. *Id.*; *see also* Lilly, *supra* note 1, at 603 (explaining Congress's intent to "protect and enhance" retirement income); PENSION AND WELFARE BENEFITS ASSOCIATION, U.S. DEP'T OF LABOR, WHAT YOU SHOULD KNOW ABOUT THE PENSION LAW 5 (1988) (stating that ERISA's rights and safeguards provide that "money will be there to pay pension funds when they are due").

³¹ *See* EMPLOYEE BENEFITS, *supra* note 3, at 17.

ticipants and their beneficiaries,³² to protect employees and improve pension plans through regulation of plan design and operation,³³ to provide the government with the means to enforce ERISA regulations,³⁴ and to establish pension insurance to protect against defined-benefit plan failure.³⁵ In general, ERISA's regulations were directed toward defined-benefit plans. Defined-benefit plans comprised the majority of private pensions at the time of ERISA's enactment³⁶ and were subject to underfunding and other abuses.³⁷ Defined-contribution plans, in contrast, are always fully funded (in the sense that the participant only has a right to funds actually in the participant's account) and do not promise a benefit, so they are essentially self-insured. Defined-contribution plans, therefore, do not fall within ERISA's minimum

³² *EMPLOYEE BENEFITS*, *supra* note 3, at 17. ERISA protects the rights of pension and welfare plan participants by providing statutory enforcement rights and access to the federal court system. *See* 29 U.S.C. § 1132(a)(1) (1988) (authorizing participant or beneficiary to bring civil action against administrator who fails to provide plan information upon request in order to recover benefits due, to enforce rights, or to clarify rights to future benefits under terms of plan); § 1132(a)(2) (empowering participant, beneficiary, fiduciary, or Secretary of Labor to bring civil action for breach of fiduciary duty).

³³ *See* 29 U.S.C. §§ 1001-1114 (1988 & Supp. V 1993). ERISA's regulatory provisions are contained in four parts. Part I covers reporting and disclosure requirements, which are designed to improve pensions and protect employees by mandating disclosure of certain plan information to the government, participants, and beneficiaries. *See* §§ 1021-1031. Part II establishes minimum vesting requirements and minimum participation standards, which are intended to lessen discrimination against lower-level employees and broaden the coverage of pension plans. *See* §§ 1051-1061. Part III sets minimum funding standards to improve the stability of certain defined-benefit pension plans. *See* § 1081-1086. Part IV defines standards of conduct for pension plan fiduciaries and prohibits certain transactions. *See* §§ 1101-1114.

³⁴ *See* 29 U.S.C. §§ 1131-1145 (1988 & Supp. V 1993). The administration and enforcement provisions of ERISA empower the Secretary of Labor to bring civil actions to enforce the provisions of ERISA's Title I and to enjoin acts in violation of these provisions. *Id.*

³⁵ *See* 29 U.S.C. §§ 1301-1461 (1988 & Supp. V 1993). Plan termination insurance is provided through the Pension Benefit Guaranty Corporation ("PBGC"), a nonprofit corporation organized within the Department of Labor, which has the power to insure certain defined-benefit plans and to collect premiums from the covered plans. *Id.*

³⁶ *See* CLARK ET AL., *supra* note 16, at 1.

³⁷ *See* COLEMAN, *supra* note 6, at xi ("The major impetus for the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) was abuse and mismanagement in the private pension system."); *see also* *EMPLOYEE BENEFITS*, *supra* note 3, at 362. One particular incident that helped prompt the passage of ERISA was the closing of the Studebaker automotive plant in Indiana. *Id.* Underfunding of the Studebaker defined-benefit pension plan relegated almost 7000 employees to receiving 15% or less of their anticipated pension benefits. *Id.*

funding standards or require pension insurance for funding protection.³⁸

II. CURRENT TREND IN PENSION PLANS

During the twentieth century, pension coverage of private employees in America grew from ten percent in the 1930s, to twenty-five percent in 1950, to more than fifty percent in 1984.³⁹ Prior to the passage of ERISA, defined-benefit plans accounted for nearly all of the growth in pensions.⁴⁰ In recent years, however, much of the growth in pensions has come from an increased number of defined-contribution plans, while the number of defined-benefit plans has slightly decreased.⁴¹ This trend, in varying degrees, appears to encompass all areas of American industry and all pension plan sizes.⁴² During the most recent years for which there are reliable data, the growth in private pensions ap-

³⁸ See 29 U.S.C. § 1321(b)(1) (1988). The statute provides that PBGC coverage does not extend to individual account plans. *Id.*; accord *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 229-30 (1985) (O'Connor, J., concurring) (noting that ERISA's termination insurance applies only to defined-benefit pension plans, and that Congress exempted defined-contribution plans from pension insurance coverage since they do not specify benefit); *Nachman Corp. v. Pension Benefit Guar. Corp.*, 446 U.S. 359, 363-64 n.5 (1980) (noting that ERISA's pension insurance does not apply to defined-contribution plans because "by definition, there can never be an insufficiency of funds" to pay participant benefits).

³⁹ See CLARK ET AL., *supra* note 16, at 1.

⁴⁰ CLARK ET AL., *supra* note 16, at 24, tbl. 3 (illustrating that defined-benefit plans comprised approximately 77% of all plans existing in 1983 that were established prior to ERISA's enactment).

⁴¹ See, e.g., Celia Silverman, *Pension Evolution in a Changing Economy*, EMPLOYEE BENEFIT RES. INST. SPECIAL REP. & ISSUE BRIEF, No. 141 (Sept. 1993). The number of employees participating in defined-contribution plans between 1975 and 1989 increased by twenty-four million, while the number of employees participating in defined-benefit plans increased by seven million between 1975 and 1983 and has remained mostly stagnant since that time, with a slight decrease between 1989 and 1990. *Id.* at 8. Between 1975 and 1989, defined-contribution plans increased as a percentage of total qualified private pension plans from 67% to 82%. *Id.* During the same period, the total number of participants in private defined-contribution plans rose from 26% to 48% of all pension plan participants. *Id.* at 9, tbl. 2. From 1983 to 1989 there was an increase of 128,000 new plans. This number reflects an increase of 171,000 defined-contribution plans and a decrease of 43,000 defined-benefit plans. *Id.*

⁴² See, e.g., CLARK ET AL., *supra* note 16, at 23, tbl. 2 (describing percentage increase in primary defined-contribution plans and decrease in primary defined-benefit plans among major industries between 1977 and 1983, including manufacturing, production, wholesale and retail sales, services, and finance); Silverman, *supra* note 41, at 12, tbl. 5 (illustrating that total number of defined benefit plans decreased for all plan sizes except those with more than 5000 participants, with greatest number of plan terminations occurring in plans with two to nine participants); *id.* at 13, tbl. 6 (indicating that total number of defined-contribution plans increased for all sizes of

pears to have slowed or stopped, while the relative increase in defined-contribution plans has continued.⁴³

A. Factors Contributing to the Trend

Analysis of the shift in the type of pension plans offered by private employers does not reveal a singular cause for the trend. Rather, there are a number of contributing factors, including increased and frequently amended government regulations that impact defined-benefit plans to a greater degree than defined-contribution plans, increased costs to comply with the regulations, growth in employment by small businesses which tend to favor defined-contribution plans, and greater portability of defined-contribution plans (which is better suited to an increasingly mobile workforce).⁴⁴

1. Government Regulation

The first of these factors, government regulation, including ERISA and its numerous amendments, has focused primarily on defined-benefit plans.⁴⁵ In 1977, for example, Congress increased the premiums to be paid to the Pension Benefit Guaranty Corporation ("PBGC") by single employer defined-benefit pension plans.⁴⁶ In 1980, the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA") was passed, which makes it more difficult

plans, with greatest number of new plans occurring in plans with two to nine participants).

⁴³ See DOL Report, *supra* note 9. Based on the most recent data from Form 5500 submissions, which are mandatory for qualified plans under both ERISA and the Internal Revenue Code, filings for defined-benefit plans decreased to 113,000 in 1990 from 132,000 in 1989, while filings for defined-contribution plans increased to 600,000 in 1990. *Id.* Assets contributed to defined-contribution plans in 1990 were more than triple the assets contributed to defined-benefit plans. *Id.*

While usage of defined-contribution plans continues to increase, the percentage of employees covered by a pension plan decreased in 1991 and 1992 by a few percentage points. *Id.*

⁴⁴ See CLARK & McDERMED, *supra* note 25, at 5.

⁴⁵ See generally CLARK ET AL., *supra* note 16, at 1-2, 4 (reviewing post-ERISA legislation and its impact on defined-benefit plans); Richard A. Ippolito, *A Study of the Regulatory Impact of the Employee Retirement Income Security Act*, 31 J.L. & ECON. 85, 87 (1988) (noting that ERISA's primary focus is defined-benefit plans); *Private Pension System is Stagnating Due to Legislative 'Tinkering'* ACLI says, 20 PENS. & BEN. REP. 1131, 1132 (BNA), (May 24, 1993) [hereinafter *Private Pension*] (noting that most legislative and regulatory changes since ERISA have been directed toward defined-benefit plans).

⁴⁶ 29 U.S.C. § 1381. The amendment increased the premium to \$2.60 per participant per year from \$1.00 per participant per year. *Id.*

for underfunded multi-employer defined-benefit plans to shift liability to the PBGC, and imposes liability upon employers for withdrawing funds from such plans.⁴⁷ Furthermore, the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA")⁴⁸ reduced the maximum annual benefit available under defined-benefit plans,⁴⁹ decreasing the ability to overfund a defined-benefit plan to compensate for anticipated inflation.⁵⁰

Regulation that disproportionately affected defined-benefit plans continued over the ensuing years, rendering these plans less attractive to employers. For example, the Retirement Equity Act of 1984, which sought to insure that employees covered under defined-benefit plans received promised benefits,⁵¹ reduced the age for vesting eligibility, introduced break-in-service protections, and liberalized survivorship rules for employee spouses.⁵² In 1986 Congress passed the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA")⁵³ to improve the financial health of the PBGC. COBRA raised the pension insurance premium for defined-benefit plans⁵⁴ and minimized PBGC involvement in plan terminations by creating two types of terminations for single employer defined-benefit pension plans: standard and distress terminations.⁵⁵ Also enacted in 1986, the Age Discrimination in Em-

⁴⁷ Multi-employer Pension Plan Amendments Act of 1980, Pub. L. No. 96-364, 94 Stat. 1208 (codified as amended in scattered sections of 29 U.S.C.).

⁴⁸ Tax Equity and Fiscal Responsibility Act ("TEFRA"), Pub. L. No. 97-248, 96 Stat. 324 (1982) (codified as amended in scattered sections of I.R.C.).

⁴⁹ *Id.* TEFRA reduced the maximum annual benefit from the lesser of 100% of compensation or \$136,425 per year to the lesser of 100% of compensation or \$90,000 per year. 96 Stat. at 505.

⁵⁰ *Id.*; cf. EMPLOYEE BENEFITS, *supra* note 3, at 10-11 (suggesting that TEFRA's reforms reflected general attitude among congressional and executive branch members that private pension plans were revenue losers for government and defined-benefit plans were too favorable to wealthy).

⁵¹ Retirement Equity Act of 1984, Pub. L. No. 98-397, 98 Stat. 1426 (codified as amended in scattered sections of I.R.C.).

⁵² *Id.*

⁵³ Comprehensive Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272, 100 Stat. 82 (1986) ("COBRA") (codified as amended in scattered sections of 29 U.S.C.).

⁵⁴ *Id.* Under the Single-Employer Plan Termination Insurance Premiums portion of COBRA, the pension insurance premium was raised to \$8.50 per participant per year from \$2.60 per participant per year, in anticipation of PBGC deficit increases. 100 Stat. at 240-41.

⁵⁵ *Id.* In "standard termination" cases, a single employer could terminate a fully funded plan without PBGC involvement. 100 Stat. at 244-48. "Distress terminations," which involve underfunded plans and necessitate PBGC indemnification, can only be implemented in specific instances approved by the PBGC. *Id.* at 248-52.

ployment Amendments of 1986 required employers to continue accruing benefits for employees who worked past normal retirement age.⁵⁶

In 1987, Congress determined that the amendments enacted under COBRA to protect the financial stability of the PBGC were insufficient. As a consequence, Congress passed the Omnibus Budget Reconciliation Act of 1987 ("OBRA 1987").⁵⁷ This Act further raised the pension insurance premium and introduced a variable scale for premiums that required additional payments for underfunded defined-benefit plans.⁵⁸ Reflecting governmental attempts to raise revenue, OBRA 1987 also increased the minimum funding standards for defined-benefit plans, further restricted company withdrawal of excess funds upon the termination of a defined-benefit plan, and placed limits on tax deductions for overfunding defined-benefit plans.⁵⁹ The Omnibus Budget Reconciliation Act of 1990 ("OBRA 1990") again raised the pension insurance premium and increased the excise tax penalty for reversion of plan assets to employers.⁶⁰ The Revenue Reconciliation Act of 1993 further reduced the maximum annual benefit for defined-benefit plans.⁶¹

As the regulation of defined-benefit plans increased, federal regulations impacting defined-contribution plans tended to be more liberal.⁶² Legislation subsequent to the passage of ERISA, as well as changes to the tax code, increased the attractiveness of defined-contribution plans. For example, the Tax Reduction Act of

⁵⁶ Age Discrimination in Employment Amendments of 1986, Pub. L. No. 99-592, 100 Stat. 3342 (codified at 29 U.S.C. § 621).

⁵⁷ Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (codified as amended in scattered sections of I.R.C.).

⁵⁸ See 101 Stat. at 1330-367 to -369. The Omnibus Budget Reconciliation Act of 1987 raised the standard annual premium for pension insurance per participant from \$8.50 to \$16, which, when combined with previous increases, resulted in a \$13.40 increase in two years. In addition, underfunded plans could be required to pay as much as \$50 per participant per year.

⁵⁹ 101 Stat. at 1330-333 to -339, 1330-359 to -360, and 1330-331 to -333.

⁶⁰ See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-562 and -573 (1990) (codified as amended at I.R.C. § 4980 and 29 U.S.C. § 1306). The 1990 OBRA increased the pension insurance premium from \$16 to \$19 and raised the excise tax penalty from 15% to 20%. *Id.*

⁶¹ See Revenue Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312, 477 (codified as amended in scattered sections of I.R.C.) (reducing maximum annual benefit under defined-benefit plans to \$118,000).

⁶² See generally CLARK & McDERMED, *supra* note 25, at 80 (noting that changes to tax code have created new options for companies to provide defined-contribution plans).

1975 gave a tax credit to employers for contributions to employee stock option plans ("ESOPs"), a form of defined-contribution plan.⁶³ The Tax Reform Act of 1976 extended these tax credits to employers who matched employee contributions.⁶⁴ The Revenue Act of 1978 created simplified employee pensions and established a new type of defined-contribution plan: the Internal Revenue Code ("IRC") section 401(k) cash or deferred arrangement.⁶⁵ The introduction of IRC section 401(k) made employee contributions tax deductible,⁶⁶ thus changing the pension landscape by creating an incentive to use employee funds as the basis of primary pension plans.⁶⁷

The Economic Recovery Tax Act of 1981 ("ERTA 1981") increased both the availability of and the deductible contribution limits of individual retirement accounts ("IRAs") and established new tax benefits for employers offering ESOPs.⁶⁸ In view of the tax incentives created by ERTA 1981, congressional attention turned away from legislation that broadened the attractiveness of defined-contribution plans and safeguarded defined-benefit funding, and focused on legislation intended to raise federal revenue.⁶⁹ In addition to reducing the maximum annual benefit for defined-benefit plans, TEFRA reduced the maximum annual contribution for defined-contribution plans.⁷⁰ The Deficit Reduction Act of

⁶³ Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (codified as amended in scattered sections of I.R.C.). This amendment created a form of Employee Stock Ownership Plan ("ESOP") that entitled the company to a tax credit rather than a deduction. *Id.* at 36-40.

⁶⁴ Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified as amended in scattered sections of I.R.C.).

⁶⁵ Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, 2785-96 (codified as amended in scattered sections of I.R.C.).

⁶⁶ See I.R.C. § 401(k) (1988 & Supp. V 1993). Employee contributions to a 401(k) plan, which would otherwise be taxable compensation, are excluded from current income for federal income tax purposes. *Id.*

⁶⁷ See Silverman, *supra* note 41, at 33 (noting that 401(k) plans provided first opportunity for most private employees to make pre-tax contributions to retirement funding); EMPLOYEE BENEFITS, *supra* note 3, at 208.

⁶⁸ Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of I.R.C.).

⁶⁹ See EMPLOYEE BENEFITS, *supra* note 3, at 10 (suggesting that ERTA 1981 was high point of government encouragement of private pensions, but that its tax reductions caused large budget deficits).

⁷⁰ See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of I.R.C.) (reducing maximum annual contribution to 25% of earnings up to \$30,000 from 25% of earnings up to \$45,475); 26 U.S.C. § 415 (1988 & Supp. V 1993).

1984 maintained the maximum limits established by TEFRA.⁷¹ Finally, the Omnibus Budget Reconciliation Act of 1989 ("OBRA 1989") increased civil penalties for breach of fiduciary duty and limited certain deductions related to ESOPs.⁷²

Additional legislation impacted both defined-benefit and defined-contribution plans.⁷³ As a whole, however, these regulations placed increasingly greater burdens on defined-benefit plans.⁷⁴ The enactment of ERISA in 1974 necessitated the revision of many existing defined-benefit plans in order to maintain tax qualified status and ensure that plans met the required levels of em-

⁷¹ See Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (codified as amended in scattered sections of I.R.C.). The Deficit Reduction Act maintained the limits on maximum annual contributions to defined-contribution plans, maintained the limits on maximum annual benefit for defined-benefit plans, and significantly impacted employee-welfare plans. *Id.*

⁷² Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2106, 2123 and 2346-54 (codified as amended in scattered sections of 29 U.S.C.).

⁷³ See, e.g., Miscellaneous Revenue Act of 1980, Pub. L. No. 96-605, 94 Stat. 3521 (codified as amended at I.R.C. § 414). For example, this Act made it more difficult for private employers to discriminate against lower-paid employees or provide pensions that favored only highly compensated employees. 94 Stat. at 3526-27; see also Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of I.R.C.) (containing regulations designed to prevent employers from directing plans in favor of the highly compensated).

In 1986, Congress reformed many of the Tax Code sections of ERISA with the Tax Reform Act of 1986 ("TRA"), Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of I.R.C.). TRA limited contributions to 401(k) plans, established two tiers of vesting for defined-benefit plans, reduced the availability of IRAs, and imposed new taxes on distributions and early withdrawals from qualified pension plans. 100 Stat. at 2411-14 (codified at I.R.C. § 219), 2446 (codified at I.R.C. § 411), 2459-61 (codified at I.R.C. § 401), and 2478-80 (codified at I.R.C. § 4980). In addition, TRA attempted to reduce the incentive to terminate defined-benefit plans by imposing an excise tax penalty on companies that recovered excess assets from plan terminations because of overfunding under the ERISA standards. *Id.* at 2478-80 (codified at I.R.C. § 4980).

⁷⁴ See, e.g., CLARK & McDERMED, *supra* note 25, at 106 (concluding that shift away from defined-benefit plans results substantially from pension regulation following ERISA); DOL Report, *supra* note 9, at 2023; Silverman, *supra* note 41, at 29 (stating that government legislation affected attractiveness of various defined-contribution plans to employers); *Groups Debate Investments, Coverage, Retiree Benefits, Rights of Participants*, 19 Pens. Rep. (BNA) 909 (June 1, 1992), available in LEXIS, Penben Library, Pensn File [hereinafter *Groups Debate*] (stating that government regulation has made defined-benefit plans particularly unattractive to small businesses, but does not account for shift by larger plans (citing Richard Ippolito, Chief Economist with PBGC)). *But cf. Reports of Defined Benefit Plan Decline Have Been Exaggerated*, DOL Official Says, 19 Pens. Rep. (BNA) 994 (June 15, 1992), available in LEXIS, Penben Library, Pensn File [hereinafter *Reports*] (suggesting that trend toward defined-contribution plans is mainly due to growth of small businesses which tend to favor these plans).

ployee protection.⁷⁵ In addition, because federal regulations changed almost yearly between 1974 and 1990,⁷⁶ pension plan administrators were continuously required to keep informed of amendments to the laws in order to evaluate the requirements for tax qualified status and make any necessary changes to the plans so as to avoid ERISA's civil penalties. Changes to a pension plan typically involve the assistance of attorneys and actuaries; therefore, modifications increase the administrative cost for plan maintenance.⁷⁷ The increased reporting requirement under ERISA and subsequent amendments also raised the administrative costs of pension plans.⁷⁸ In addition, many employers must pay the premium costs of the mandatory pension insurance associated with defined-benefit plans.⁷⁹ The combination of these cost burdens has led some employers to determine that defined-benefit plans are not worth maintaining.⁸⁰

These cost burdens have a greater impact on small employers—those with under one hundred employees—than on large employers.⁸¹ Large employers normally incur a lower cost per participant for plan administration, and the greater accumulated

⁷⁵ See CLARK & McDERMED, *supra* note 25, at 79 (noting that "virtually all" existing defined-benefit plans had to be modified after ERISA, thereby limiting flexibility and scope of pension plans and reducing potential gains).

⁷⁶ See *supra* notes 45-73 and accompanying text.

⁷⁷ See CLARK & McDERMED, *supra* note 25, at 79-80 (noting that expense of preparing new defined-benefit plans may incorporate some of costs of potential future modifications in addition to increased administrative costs).

⁷⁸ See CLARK & McDERMED, *supra* note 25, at 4, 79-80.

⁷⁹ See *supra* notes 46, 54, 58, and 60 (noting increase in pension insurance premium between 1974 and 1990 from \$1 per participant per year to \$19 per participant per year, and possibly up to \$50 per participant per year for underfunded plans); see also Charles D. Lockwood, *Clinton Administration Introduces Pension Reform Legislation*, 9 J. COMP. & BEN. 5, 20 (1994) (noting introduction of legislation that may raise PBGC premiums even further).

⁸⁰ See, e.g., *Private Pension*, *supra* note 45, at 1131 (stating that due to frequent changes in pension laws, employers begin to feel that "cost benefit in terms of the amount available for retirement savings purposes" is outweighed by "what they have to do to make sure their plans comply with the law" (quoting Stephen Kraus, chief counsel for American Council of Life Insurance)); Joel Chernoff, *Crushed by the Weight; 15 Years Later, Is ERISA Too Much of a Good Thing?*, PENSIONS & INVESTMENT AGE, Sept. 4, 1989, at 1. The Chernoff article relates the comments of the chairman and chief executive officer of a retail chain in Michigan that terminated its defined-benefit pension plan with assets of \$2.3 million, calling the plan "too burdensome and expensive," and leaving only a 401(k) plan for its 750 employees. *Id.* The plan's termination was due to "the legislation (and regulations) subsequent to [ERISA] that have made the whole arena of providing retirement benefits extremely onerous." *Id.*

⁸¹ See Silverman, *supra* note 41, at 31.

funds can earn a higher rate of return on investment.⁸² Additionally, large employers may use defined-benefit plans to encourage long-term employment. Since vesting requirements and benefit accrual are weighted toward the later years of employment under a defined-benefit plan, short-term employees tend to receive only a fraction of their anticipated benefits when they leave employment.⁸³ Large employers may prefer long-term employment because they often have high training costs and tend to provide more opportunity for employees to move and advance within the company.⁸⁴ Unions, also typical sponsors of large defined-benefit plans, similarly use defined-benefit plans as an incentive for continued union membership.⁸⁵

2. Shift Toward Smaller Employers

As the foregoing suggests, large employers will typically prefer defined-benefit pension plans despite the greater cost. This preference highlights another factor in the trend away from defined-benefit plans—the shift in the American workforce from large unionized manufacturing employers to small companies and

[I]n each year between 1981 and 1991, per participant administrative costs for defined benefit plans, both one-time costs required for compliance and ongoing costs, were higher for plans with fewer participants. In 1990, plans with 15 participants experienced a per participant administrative cost of \$805.45, compared with the per participant cost of \$161.73 for plans with 500 participants and the per participant cost of \$55.50 for plans with 10,000 or more participants.

Id.

⁸² See CLARK ET AL., *supra* note 16, at 11.

⁸³ See *id.* at 8-10; CLARK & McDERMED, *supra* note 25, at 50-52 (arguing that weighting of defined-benefit plans results in reduced employee turnover); STEVEN G. ALLEN ET AL., PENSIONS AND LIFETIME JOBS: THE NEW INDUSTRIAL FEUDALISM REVISITED 7-9 (N. C. State Univ., Dep't of Economics and Business, Faculty Working Paper No. 116, Jan. 1988) (noting correlation between vested pension rights and probability of employee turnover); Silverman, *supra* note 41, at 23-25 (stating that employers seeking long-term employees are more likely to offer defined-benefit plans because slow rate of accrual in initial years and faster rate of accrual for employees with long service tend to reward long tenures); Alan Stiteler, *Retirement Plans: A Closeup Look at What's New; Employee Benefits*, PENSION WORLD, Sept. 1992, at 20 (indicating that long-term employees are favored by defined-benefit plans).

⁸⁴ See CLARK & McDERMED, *supra* note 25, at 32 (noting that company with high training costs may use defined-benefit pension plan as part of "total compensation package to try to keep its workers"); Silverman, *supra* note 41, at 28 (remarking that some employers use defined-benefit plans to increase long-term service, which can result in increased productivity and efficiency due to training and repetition).

⁸⁵ See CLARK & McDERMED, *supra* note 25, at 93-95 (stating that union members in given industry are 19% to 30% more likely to have a pension than non-members and 8.4% more likely to have defined-benefit plan than defined-contribution plan).

service firms.⁸⁶ Some estimates credit this shift in employment demographics with responsibility for one-half of the trend from defined-benefit plans to defined-contribution plans, since small companies and service firms which do offer a pension plan typically offer defined-contribution plans.⁸⁷ Decreased participation in defined-benefit plans may also be attributable to the downsizing of large industrial companies and the departure of employees from large firms that offer such plans.⁸⁸

3. Increased Mobility of American Workers

As the nature of the American workforce has changed, the American worker has become more mobile.⁸⁹ Estimates indicate that typical American workers born after World War II will have at least ten jobs over the course of their working lives.⁹⁰ Workers who do not remain at a single job for a long period are better served by defined-contribution plans.⁹¹ An employee covered by a

⁸⁶ See generally LABOR FORCE STATISTICS, *supra* note 24, at 383-94. Specifically, private wage and salary employment in manufacturing decreased approximately 1% between 1974 and 1987, while private wage and salary employment in finance and other service industries increased between 80% and 90% during the same period. *Id.*

⁸⁷ See *Groups Debate*, *supra* note 74 (crediting half of shift over last ten years to "changes in employment from large, unionized firms in the manufacturing sector, where defined benefit plans have dominated, to nonunion, service industry jobs in smaller firms, where defined contribution plans have dominated" (quoting Richard Ippolito, chief economist for PBGC)).

⁸⁸ See, e.g., DOUGLAS L. KRUSE, PENSION SUBSTITUTION IN THE 1980S: WHY THE SHIFT TOWARD DEFINED CONTRIBUTION PENSION PLANS? 17 (National Bureau of Economic Research, Working Paper No. 3882, 1991) (finding that primary cause of shift toward defined-contribution plans is declining number of participants in companies with existing defined-benefit plans); *Private Pension*, *supra* note 45, at 1131 (noting that shift in nation's industrial composition reduced workforce at many large companies and increased number of Americans employed by small service companies which favor defined-contribution plans). But see CLARK ET AL., *supra* note 16, at 2 ("[T]he increased incidence of defined contribution plans is not due to changes in the industrial structure of the economy or demographic characteristics of the workforce.").

⁸⁹ See ALLEN ET AL., *supra* note 83, at 1 (citing fact that "[e]ach month between 4 and 5 percent of all workers in manufacturing leave their jobs" as example of current flexibility in American workforce, especially among younger employees).

⁹⁰ See *id.* ("[T]he typical American worker will eventually hold 10 jobs, 8 of them by age 40."); Special Sponsored Section, *Defined Contribution Plans*, INSTITUTIONAL INVESTOR, Nov. 1991, at 131, 133 [hereinafter Special Section] (recognizing that employees no longer maintain one job throughout their lifetimes and that baby-boomers average "11 different jobs between leaving college and the end of their careers") (quoting Richard Garnitz of Lifespan Services, Inc.).

⁹¹ See generally Silverman, *supra* note 41, at 14 (noting that young and mobile employees can receive higher levels of retirement income with defined-contribution plans if they make proper investment decisions); *DOL Report*, *supra* note 9, at 2023 (stating that flexibility of defined-contribution pension plans is helpful to more mobile

defined-contribution plan is immediately vested in full for the funds contributed and controls these funds after leaving employment.⁹² Employees can often roll these funds into a new defined-contribution plan provided by a subsequent employer or into an individual retirement account of their own.⁹³ Thus, a young, mobile employee may realize a greater return on pension funds with a defined-contribution plan than with a defined-benefit plan because of the greater portability of defined-contribution plans.⁹⁴

B. Impact of the Trend on Employees

This trend toward increased use of defined-contribution plans has an important consequence: it shifts the burden of providing sufficient retirement income to the employee.⁹⁵ Under a defined-benefit plan, a plan administrator, generally an investment professional, will manage the plan's investments and shift funds among investment options to compensate for inflation, market fluctuations, and unexpected poor returns.⁹⁶ Employees, however, tend to think of the funds as savings and invest them in the safest options, especially 401(k) and similar plans in which the employee

workforce "including women who take time out of the workforce . . . because of child rearing responsibilities" (citing statement by Richard Hinz, chief economist and director of research for Pension and Welfare Benefits Administration)).

⁹² See CLARK & McDERMED, *supra* note 25, at 9 (recognizing that because employee contributions to defined-contribution plans are always immediately vested in full, employees always have unrestricted ownership).

⁹³ See Michael J. Clowes, *Investors at Brink of Turbulent Changes; Next Decade Promises to Forever Put to Rest Business as Usual*, PENSIONS & INVESTMENTS, Nov. 1, 1993, at 1 (indicating that employees regularly take defined-contribution plan account balances with them when changing jobs).

⁹⁴ See *supra* note 91.

⁹⁵ See Silverman, *supra* note 41, at 14. "Concern over the increased prevalence of defined contribution plans has arisen because these plans serve to shift the burden of planning for retirement from employers to individuals and could result in reduced retirement security for some individuals." *Id.* In general, with a defined-contribution plan, employees bear the risk of inflation and suitable investment return, while an employer bears these risks with defined-benefit plans. *Id.* at 26-27. See also Nancy Van Gelder, *Defined Contribution Upsurge Shifts Sponsor Obligation*, PENSION WORLD, July 1993, at 23, 25 (noting that trend toward defined-contribution plans shifts responsibility for investment choices from plan sponsors to participants); Vosti, *supra* note 17, at 25 (noting that employees are forced to become more sophisticated about investing since their investment decisions will determine retirement income).

⁹⁶ See EMPLOYEE BENEFITS, *supra* note 3, at 76 (noting that employers sponsoring defined-benefit plans will base amount contributed on actuarial calculations of investment performance, as well as ERISA's minimum funding requirements).

selects investments from a limited number of choices.⁹⁷ In general, employees have been drawn to low-risk investments, such as guaranteed investment contracts ("GICs"),⁹⁸ typically among the worst performers over time.⁹⁹ Thus, if employees, who typically lack financial or investment training, do not make good investment choices, the income waiting for them at retirement could be much less than they anticipated.¹⁰⁰ Younger employees in particular will be hurt by this type of investing, since the compounding of their returns over an extended period will typically be lower.¹⁰¹

⁹⁷ See, e.g., Special Section, *supra* note 90, at 139 (observing that many plan participants view themselves as savers rather than investors); *DOL Report*, *supra* note 9, at 2023 (noting that participants tend to invest in overly conservative manner); *accord* Vosti, *supra* note 17, at 30 (suggesting that some plan participants will remain adverse to any financial risk, even if educated about financial choices).

⁹⁸ See April Klimey, *From Savers to Investors: Encouraging a Change of Focus in 401(k) Plans*, INSTITUTIONAL INVESTOR, Sept. 1993, at 1 (citing survey data indicating that participants maintain more than 33% of their funds in guaranteed investment contracts ("GICs") and additional 10% in other fixed-income investments); Archie B. Spangler, *A Disciplined Approach to 401(k)/404(c) Retirement Plan Administration*, PENSION WORLD, May 1993, at 18, 19 (estimating that 60% to 80% of total 401(k) assets are invested in some form of guaranteed investment); Vosti, *supra* note 17, at 23 (noting that participant investment choices are predominantly in GICs, and that surveys indicate 57% of participants would choose GICs over equities or other options); see also Advisory Council on Employee Welfare and Pension Benefits Plans, U.S. Dep't of Labor, Report of Interim Findings and Preliminary Conclusions of the Defined Contribution Work Group 22-23 (1993) [hereinafter ADVISORY COUNCIL]. The Advisory Council intends to conduct a study in 1994 evaluating the way assets in participant-directed defined-contribution plans are invested. *Id.* Among the issues to be examined are the effect of the trend toward self-directed investments on benefit levels, whether self-directed investments yield comparable returns to those provided by trustee-directed investments, and the likely effect of the ERISA § 404(c) regulations on benefit levels. *Id.*

⁹⁹ See Fred Williams, *GIC Type Funds are Suffering*, PENSIONS & INVESTMENTS, May 16, 1994, at 3 (noting that many normally stable GICs lost value because of recent sharp increase in interest rates); Spangler, *supra* note 98, at 19 (citing survey data indicating that "such investments are among the worst performing asset classes over time"); Janie Kass & Valerie Wise, *Employee-Directed Investments: Viewing Sponsor and Participant Involvement*, PENSION WORLD, April 1993, at 14, 15 (estimating "that the one-year return net of inflation for small stocks will be between -33.16% and +52.96%. For GICs, however, it will be 0% to +5%.").

¹⁰⁰ See, e.g., Van Gelder, *supra* note 95, at 25 (noting that survey data indicate that "most employees [participating] in defined-contribution plans vastly underestimate the impact of inflation; [they] tend to put too much of their money in low-yield, short term issues . . ."); *Defined Contributions Recordkeeping; Higher Standards in Technology and Customer Service Transform 401(k) Recordkeeping*, INSTITUTIONAL INVESTOR, May 1992, at 10 [hereinafter *Recordkeeping*] (indicating that investors need to be educated about including aggressive investments in their portfolios).

¹⁰¹ See Van Gelder, *supra* note 95, at 25 (suggesting that younger pension plan participants require education "to become comfortable with the short-term fluctua-

Another concern for future retirees is that the trend toward defined-contribution plans may be eliminating one leg of the "three-legged stool" envisioned by Congress when it established ERISA.¹⁰² Personal savings decreased in the 1980s, and employees contributing to their own retirement plans may not see a need, or have the discretionary income, for additional personal savings.¹⁰³

Finally, the security of employees' retirement income is now in question. In one sense, defined-contribution pension plans are inherently more secure than defined-benefit plans because they are always fully funded.¹⁰⁴ By self-directing the investment of the funds, however, employees bear the risk of loss if the investment should fail.¹⁰⁵ Employees may fail to recognize, or not have the time to evaluate, the financial indicators that an investment planner relies on before transferring funds between investments. For example, the majority of self-directed pension plan investors transferred funds to the stock market after it reached its high in 1987, and bailed out after the market crashed soon thereafter.¹⁰⁶

Part of this problem may result from an employee's inability to transfer funds rapidly between investment options. New regulations promulgated under IRC section 404(c)¹⁰⁷ allow employers seeking to comply with the discretionary regulations to reduce their potential for fiduciary liability if they provide employees

tions in stocks and to be confident that their savings will grow substantially by retirement time").

¹⁰² See *supra* note 29 and accompanying text; Special Section, *supra* note 90, at 137 ("Financial planners like to refer to the three legged stool for retirement—pension, Social Security and personal savings. The 401(k) [plan] is the third leg of this stool."); ADVISORY COUNCIL, *supra* note 98, at 7 (stating that growth of 401(k) defined-contribution plans is "effectively eliminating one leg of the three legged retirement stool—that of *employer-paid* pension and profit sharing plans" (quoting M. Cindy Hounsell, Esq.)).

¹⁰³ See Private Pension, *supra* note 45, at 1131 (noting that favorable tax treatment of pension plans would provide disposable income that could be used for personal savings).

¹⁰⁴ See *supra* note 38 and accompanying text.

¹⁰⁵ See Silverman, *supra* note 41, at 20 (noting that poor investing by participants can lead to decreased benefits, causing participants to retire with less benefits or continue working past normal retirement age to build additional retirement income).

¹⁰⁶ See Spangler, *supra* note 98, at 19 (pointing out that 93.6% of investment return is associated with asset allocation decision).

¹⁰⁷ See 29 C.F.R. § 2550.404c-1 (1992) (amending rules and regulations for fiduciary responsibility under ERISA).

with at least quarterly opportunities to transfer funds.¹⁰⁸ Although these regulations provide greater flexibility, quarterly transfers may still not provide adequate access to funds in the event of a market crash and may not protect an employee who transfers investments out of the market after a crash. Some companies offer more frequent transfer options;¹⁰⁹ however, these options increase the administrative cost of a plan and do not protect those employees who lack the expertise required to make sound transfers.

C. *Impact of the Trend on Employers*

1. The Employer's Fiduciary Responsibilities

One of the cornerstones of ERISA's employee pension protection policy is the expansion of fiduciary responsibility and the regulation of fiduciaries' activities.¹¹⁰ Under ERISA,

[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has

¹⁰⁸ See 29 C.F.R. § 2550.404c-1(b)(2)(ii)(C)(1) (1993). The regulation provides, in pertinent part, that a plan may impose "reasonable restrictions on the frequency with which participants and beneficiaries may give investment instructions" provided "[a]t least three of the investment alternatives made available . . . which constitute a broad range of investment alternatives, permit participants and beneficiaries to give investment instructions no less frequently than once within any three month period." *Id.*

¹⁰⁹ See Vosti, *supra* note 17, at 26, 28. For example, Hewlett-Packard Corp. is instituting daily investment valuations and more frequent transfers for its employees in order "to avoid the potential problems that surfaced immediately after the October 1987 market crash." *Id.* at 29. Administrators of defined-contribution plans also indicate that daily transfers, although not likely to be used by all participants, provide flexibility and added security to participants at little additional administrative cost. *Id.* at 28, 29; accord Special Section, *supra* note 90, at 141 (quoting provider of 401(k) mutual funds who suggested that plan administrators allow daily investment transfers); *Recordkeeping*, *supra* note 100, at 10 (indicating that daily valuations, once rare in pension plans, are becoming common).

¹¹⁰ See generally, H.R. REP. NO. 533, 93d Cong., 2d Sess. 36 (1973), reprinted in 1974 U.S.C.C.A.N. 4639. The report by the Committee on Education and Labor indicated that there were few federal standards applicable to fiduciaries. *Id.* at 4645-46. See also H.R. REP. NO. 807, 93d Cong., 2d Sess. 37 (1974), reprinted in 1974 U.S.C.C.A.N. 4670, 4681 (noting that pension funds had been used and administered improperly); S. REP. NO. 127, 93d Cong., 2d Sess. 48 (1974), reprinted in 1974 U.S.C.C.A.N. 4838, 4847 (finding conduct and administration of pension plans to be area of concern).

any discretionary authority or discretionary responsibility in the administration of such plan.¹¹¹

Courts have broadly interpreted this definition.¹¹² Any exercise of control over pension plan assets has been deemed to create fiduciary status.¹¹³ Plan assets must be held in trust for the exclusive benefit of plan participants. Fiduciaries must follow trust law, avoid proscribed conflicts of interest,¹¹⁴ and comply with ERISA's reporting and disclosure requirements.¹¹⁵ Although fiduciary responsibilities provide substantial protection for defined-

¹¹¹ 29 U.S.C. § 1002(21)(A) (1988).

¹¹² See, e.g., *Mutual Life Ins. Co. v. Yampol*, 840 F.2d 421, 425 (7th Cir. 1988) (reflecting consistently broad construction of ERISA's definition of fiduciary duty); *Leigh v. Engle*, 727 F.2d 113, 126 (7th Cir. 1984) (noting that ERISA's entire regulatory scheme indicates congressional concern with protecting participants and beneficiaries, and thus should be interpreted broadly), *aff'd*, 858 F.2d 361 (7th Cir. 1988), *cert. denied*, 489 U.S. 1078 (1989); *Iron Workers Local No. 272 v. Bowen*, 624 F.2d 1255, 1259 (5th Cir. 1980) (holding that annuity fund was "employee benefit plan" and subject to ERISA's fiduciary requirements); *Martin v. Walton*, 773 F. Supp. 1524, 1526 (S.D. Fla. 1991) (stating that fiduciary standards of conduct under ERISA "are to be governed, interpreted and judicially determined both in light of the common law of trusts, and the special nature, purpose and intent of employee benefit plans") (quoting *Donovan v. Mazzola*, 2 Employee Benefits Cas. (BNA) 2115, 2133 (N.D. Calif. 1981), *aff'd*, 716 F.2d 1226 (9th Cir. 1983), *cert. denied*, 464 U.S. 1040 (1984)); *Buehler Ltd. v. Home Life Ins. Co.*, 722 F. Supp. 1554, 1562 (N.D. Ill. 1989) (noting that courts define term "fiduciary" broadly to effectuate Congressional intent of ERISA).

¹¹³ See, e.g., *Fechter v. Connecticut Gen. Life Ins. Co.*, 800 F. Supp. 182, 197 (E.D. Pa. 1992) (holding that factual determination of defendant's possession or control of decision-making authority, or both, is required to establish fiduciary duty).

¹¹⁴ See 29 U.S.C. § 1104(a)(1) (1988 & Supp. 1992). A fiduciary must discharge his duties:

(A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter or subchapter III of this chapter.

Id.; see also § 1106 (listing specific proscribed actions which would, if taken, constitute breach of fiduciary duty).

¹¹⁵ See 29 U.S.C. §§ 1021-1031 (1988 & Supp. 1992) (containing ERISA's reporting and disclosure requirements). The provisions require that a summary plan description containing specific information be furnished to participants upon joining a pension plan and at subsequent specified intervals. *Id.* § 1024(b). Annual reports must also be provided to participants, *id.*, and to the Secretary of Labor. *Id.* § 1024(a).

benefit plan participants, who do not have control over the manner in which pension funds are invested, defined-contribution plan participants control where the assets of their individual accounts are invested.¹¹⁶ Since courts have a broad range of remedies available to them for breach of fiduciary duty,¹¹⁷ the question of who has fiduciary status under a defined-contribution plan is important.

ERISA specifically excludes employees who exercise control over their own accounts from fiduciary responsibility to other participants. Section 404(c)¹¹⁸ provides as follows:

In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account, if a participant or beneficiary exercises control over the assets in his account (as determined under regulations of the Secretary)—

(1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise¹¹⁹

If an employer is acting as a plan manager or administrator, or has discretionary authority or discretionary control over plan management,¹²⁰ the employer will undoubtedly have fiduciary obligations with respect to these functions.¹²¹ Courts, however, have

Additionally, upon written request, plan administrators must provide participants and other beneficiaries with a statement of the benefits accrued. *See id.* § 1024(b).

¹¹⁶ *See supra* note 15.

¹¹⁷ *See, e.g.,* *Eaves v. Penn*, 587 F.2d 453, 462 (10th Cir. 1978) (noting that legislative history behind ERISA indicates congressional intent to provide broad remedies to participants and beneficiaries for fiduciary breaches); *Marshall v. Snyder*, 572 F.2d 894, 901 (2d Cir. 1978) (examining legislative intent to remove barriers to effective enforcement of fiduciary duties).

¹¹⁸ *See* 29 U.S.C. § 1104(c) (1988).

¹¹⁹ *Id.*

¹²⁰ *See* *Mitnik v. Cannon*, 784 F. Supp. 1190, 1193 (E.D. Pa. 1992) (noting that fiduciary is one who has discretionary authority or control over management or disposition of funds), *aff'd*, 989 F.2d 488 (3d Cir. 1993).

¹²¹ *See, e.g.,* *Adams v. LTV Steel Mining Co.*, 936 F.2d 368, 370 (8th Cir. 1991) (holding that under dual capacity doctrine employer can act as both employer and plan fiduciary, but will be governed by ERISA's fiduciary standards only to extent employer acts in fiduciary capacity), *cert. denied*, 112 S. Ct. 968 (1992); *Payonk v. HMW Indus., Inc.*, 883 F.2d 221, 225 (3d Cir. 1989) (stating that "where an administrator of a plan decides matters required in plan administration or involving obligations imposed upon the administrator by the plan, the fiduciary duties imposed by ERISA attach"); *Amato v. Western Union Int'l Inc.*, 773 F.2d 1402, 1416-17 (2d Cir. 1985) (holding that employers "assume fiduciary status 'only when and to the extent' that they function in their capacity as plan administrators, not when they conduct business that is not regulated by ERISA") (quoting *Amato v. Western Union Int'l Inc.*, 596 F. Supp. 963, 968 (S.D.N.Y. 1984)) *cert. dismissed*, 106 S. Ct. 1167 (1986).

held that an employer does not have fiduciary responsibilities when the employer has no discretionary authority or control over the pension plan, but merely serves a ministerial function.¹²²

Congress recently promulgated regulations that interpret ERISA section 404(c).¹²³ These regulations allow employers to limit their potential fiduciary liability in certain cases involving employee-directed defined-contribution plans.¹²⁴ Compliance is not mandatory;¹²⁵ however, one can reasonably assume that most employers will be agreeable to limiting their potential liability by following the regulations.¹²⁶ To comply, the employer must provide the participant or beneficiary with the opportunity to choose from a broad range of investment alternatives, consisting of at least three different categories, each category having materially

¹²² See *Mitnik*, 784 F. Supp. at 1193 (noting that merely ministerial role does not trigger fiduciary duties); *Kerns v. Benefit Trust Life Ins. Co.*, 790 F. Supp. 1456, 1460 (E.D. Mo. 1992) (noting that ERISA rejects ministerial functions as sufficient to create fiduciary liability), *aff'd*, 992 F.2d 214 (8th Cir. 1993); see also 29 C.F.R. § 2509.75-8 (1993) (providing that one who performs purely ministerial functions is not fiduciary under Department of Labor regulations).

¹²³ ERISA § 404(c) (codified at 29 U.S.C. § 1104(c) (1988)) provides:

In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account, if a participant or beneficiary exercises control over the assets in his account (as determined under regulations of the Secretary)—(1) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and (2) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.

Id.

¹²⁴ See 29 C.F.R. § 2550.404c-1 (1993). The new regulations provide guidelines for determining whether a participant or beneficiary will be considered to have exercised independent control: "[A] participant or beneficiary will be deemed to have exercised control . . . [if] the participant or beneficiary was provided a reasonable opportunity to give instructions with respect to such incidents of ownership." § 2550.404c-1(c)(1)(ii). However, "[w]hether a participant or beneficiary has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case." § 2550.404c-1(c)(2).

¹²⁵ See Special Section, *supra* note 90, at 135 (noting that voluntary compliance with 404(c) regulations limits employer liability). See generally 29 C.F.R. § 2550.404c-1 (1993). If an employer or other fiduciary fails to comply with the regulations, the participant or beneficiary will not be considered to have exercised independent control, and the fiduciary exception will not apply. See *id.*

Whether a participant or beneficiary has exercised independent control is a fact-specific inquiry. *Id.* § 2550.404c-1(c)(2).

¹²⁶ See, e.g., Robert A. DiMeo & William A. Schneider, *Common Sense Approach Offered as a Way to Deal with Compliance of 404(c)*, PENSION WORLD, April 1993, at 22, 22 (suggesting that every plan sponsor would want to comply with § 404(c) regulations); Special Section, *supra* note 90, at 135 (noting that many plan sponsors want to comply to protect themselves from potential lawsuits).

different risk factors and return characteristics.¹²⁷ The participant must have individual control over the assets¹²⁸ and at least quarterly opportunities to transfer plan funds.¹²⁹ Lastly, the employer must provide participants with information regarding fees, investment instructions and limitations, and copies of financial data and prospectuses.¹³⁰ If these requirements are met, the employer is relieved of fiduciary liability for any adverse financial consequences of investments directed by the employee.¹³¹ Nevertheless, the employer and the plan fiduciary are still liable for any other breach of fiduciary duty, such as the failure to execute the instructions of the participant or lack of prudence in selecting investment options.¹³² In summary, the regulations require that each participant be given ample information and opportunity to properly direct his or her investments before the employer will be relieved of fiduciary responsibility for those investments. Because courts typically construe ERISA's fiduciary duty broadly to protect employees, it is uncertain how these regulations will be construed in the context of shielding *employers* from liability.¹³³

¹²⁷ See 29 C.F.R. § 2550.404c-1(b)(3) (1993). The regulations further require that each of the alternatives be "diversified" and "in the aggregate enable the participant or beneficiary by choosing among them to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant or beneficiary." *Id.*

¹²⁸ See *supra* note 124.

¹²⁹ See 29 C.F.R. § 2550.404c-1(b)(2)(ii)(C)(1) (1993) (requiring that "[a]t least three of the investment alternatives" permit "investment instructions no less frequently than once within any three month period").

¹³⁰ See 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1) (1993) (listing information that must be provided to participant or beneficiary).

¹³¹ See *supra* note 121; see also *Arakelian v. National W. Life Ins. Co.*, 748 F. Supp. 17, 22 (D.D.C. 1990) (holding that employer with no control over administration of its pension plan does not incur fiduciary liability for failing to monitor plan performance). *But cf.* *Great Lakes Steel v. Degendorf*, 716 F.2d 1101, 1104 (6th Cir. 1983) (holding that employer could sue as fiduciary of welfare plan because Congress did not intend to prevent employers from assuming fiduciary powers and liabilities); *U.S. Steel Corp. v. Pennsylvania Human Relations Comm'n*, 669 F.2d 124, 127 (3d Cir. 1982) (recognizing legislative presupposition that employer sponsors would frequently be fiduciaries).

¹³² See 29 C.F.R. § 2550.404c-1 (1993) (failing to extend fiduciary exemption beyond provisions related to employee-directed investments); see also *Leigh v. Engle*, 727 F.2d 113, 133 (7th Cir. 1984) (noting that under ERISA one may have fiduciary status for certain activities but not for other activities), *aff'd*, 858 F.2d 361 (7th Cir. 1988), *cert. denied*, 489 U.S. 1078 (1989).

¹³³ See *supra* note 117.

2. The Role of Investment Advisors

An investment advisor who suggests investment alternatives for a pension plan has a definite fiduciary duty to select alternatives prudently.¹³⁴ In addition, if an employer provides investment instructions to employees in order to comply with ERISA section 404(c) regulations,¹³⁵ the employer may be considered a fiduciary. Similarly, an investment advisor who is hired by an employer to provide investment instructions to employees is a fiduciary under the terms of ERISA if the advisor is compensated for services rendered.¹³⁶

The Department of Labor defines investment advice as guidance that goes to the value of securities or other property under a plan, or recommendations regarding investment in such property or securities.¹³⁷ Whether a party that provides investment instructions will avoid liability for breach of fiduciary duty under the section 404(c) regulations will likely depend on the specificity of the instructions given. Employers may be fearful of giving detailed instructions to employees and thereby creating fiduciary status. If, for example, the advice is general in nature, discussing types of investments and various ways to invest, it is possible that the instructing party will not be exposed to fiduciary liability for the employee's investments.¹³⁸ Once specific investments are rec-

¹³⁴ See *GIW Indus. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 895 F.2d 729, 731-32 (11th Cir. 1990) (holding that investment advisor must make thorough investigation of investments with regard to specific plan requirements to satisfy prudent man standard imposed upon ERISA fiduciaries); *DeBruyne v. Equitable Life Assurance Soc'y of United States*, 720 F. Supp. 1342, 1346-47 (N.D. Ill. 1989) (finding fiduciary duty to examine investments and diversify them, and to use care, skill, and prudence in selecting investments), *aff'd*, 920 F.2d 457 (7th Cir. 1990); Ann L. Combs, *Pension Trends*, 18 REC. SOC'Y OF ACTUARIES 1839, 1842 (1992) (noting that "[s]ection 404(c) never relieves fiduciaries, however, from their liability in selecting the investment alternatives"); see also *Donovan v. Mazzola*, 716 F.2d 1226, 1231 (9th Cir. 1983) (holding that, under ERISA, proper standard to examine fiduciary's action is prudent person rule), *cert. denied*, 464 U.S. 1040 (1984).

¹³⁵ See, e.g., *Van Gelder*, *supra* note 95, at 23 (noting that employees may be unable to exercise independent control over investments if they do not have requisite knowledge); *DiMeo & Schneider*, *supra* note 126, at 22-23 (explaining importance of offering enough alternatives for diversification without confusing participant).

¹³⁶ See 29 U.S.C. § 1002(21)(A) (1988).

¹³⁷ See 29 C.F.R. § 2510.3-21(c) (1993).

¹³⁸ See 29 C.F.R. § 2550.404c-1 (1993); see also *Schloegel v. Boswell*, 994 F.2d 266, 272 (5th Cir.) (holding that consultant's investment proposal was not effective control and did not give rise to fiduciary responsibility), *cert. denied*, 114 S. Ct. 440 (1993).

ommended, however, the instructing party is likely to be deemed a fiduciary with regard to these investments.¹³⁹

3. The Employer's Other Considerations

A final consideration for employers resulting from the shift to defined-contribution plans is the ability to encourage long-term employment.¹⁴⁰ Studies show that defined-benefit plans tend to attract and encourage long-term employees, while defined-contribution plans tend to attract and encourage mobile employees.¹⁴¹ Defined-benefit plans also accord the employer a greater degree of control over an employee's length of service and retirement age, while defined-contribution plans do not.¹⁴² Since the demographics of the American workforce indicate a continuing shift toward more mobile employees,¹⁴³ it is uncertain what long-term impact, if any, the trend toward defined-contribution plans will have upon length of service.

III. SUGGESTED MEASURES FOR RESPONDING TO THE CURRENT TREND

One aspect in which the trend toward defined-contribution plans potentially diminishes employee protections involves diversification of investment. ERISA requires plan trustees to diversify "the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so."¹⁴⁴ For defined-benefit plans, diversification is crucial to acting prudently and avoiding liability for breach of fiduciary duty.¹⁴⁵

¹³⁹ See, e.g., *Olson v. E.F. Hutton & Co., Inc.*, 957 F.2d 622, 625-26 (8th Cir. 1992) (concluding that fiduciary status could be imposed upon account broker giving investment advice which he had reason to know was being used as primary basis for investment decisions); *Fetcher v. Connecticut Gen. Life Ins. Co.*, 800 F. Supp. 182, 204 (E.D. Pa. 1992) (noting that professionals are ERISA fiduciaries if they assume management or administrative responsibilities, but merely giving professional advice does not create fiduciary status); see also *Van Gelder*, *supra* note 95, at 25 (suggesting distinction between investment education with no fiduciary responsibility and investment direction that would create fiduciary obligations).

¹⁴⁰ See *supra* notes 83-93 and accompanying text.

¹⁴¹ See *Silverman*, *supra* note 41, at 23.

¹⁴² *Silverman*, *supra* note 41, at 22 (noting that "employers often find it highly desirable to be able to reduce their workforce on a voluntary basis" with early retirement programs "by offering incentives through a defined benefit pension plan").

¹⁴³ See *supra* notes 88-90 and accompanying text.

¹⁴⁴ 29 U.S.C. § 1104(a)(1)(C) (1988).

¹⁴⁵ See, e.g., *Brock v. Citizens Bank*, 841 F.2d 344, 346 (10th Cir.) (holding that investment of over 65% of plan assets in commercial real estate, absent showing that

In contrast, while self-directed defined-contribution plans must provide a "broad range of investment alternatives,"¹⁴⁶ no minimum diversification of actual investments is required.¹⁴⁷ For example, a pension plan trustee who invested fifty percent or more of the assets of a plan, other than an ESOP, into a single company's stock would be liable for breach of fiduciary duty if the investment failed.¹⁴⁸ An employee who invested fifty percent or one hundred percent of his or her self-directed assets in one company's stock,¹⁴⁹ however, would likely have no recourse if the company failed. It is submitted that for this reason employees with defined-contribution pension plan coverage, especially those with little or no financial acumen, would benefit from some type of mandatory minimum diversification requirement. This requirement could be tailored to suit different employment situations and varying levels of financial sophistication among employees.

A second area in which participants in defined-contribution plans lack the protection envisioned by ERISA is pension plan insurance. The PBGC provides insurance against the termination of defined-benefit plans that lack sufficient funds to pay pension liabilities.¹⁵⁰ No such protection is currently provided for defined-contribution plans, however, since they are fully funded.¹⁵¹ Thus, the beneficiary of a defined-benefit plan that was underfunded at termination because of a collapse in the market would receive

investment was prudent, violated diversification requirements of § 1104(a)(1)(c) and constituted fiduciary breach), *cert. denied*, 488 U.S. 829 (1988); *Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Haw. 1980) (placing burden on defendant to show that failure to diversify did not create risk of large losses to pension plan). The *Marshall* court held that a commitment of 23% of the total plan assets to a single loan subjected a disproportionate amount of the plan assets to the risk of a large loss, and that the defendant's burden "is not merely to prove that the investment is prudent, but that there is no risk of large loss resulting from the non-diversification." *Id.*

¹⁴⁶ See *supra* note 127 and accompanying text.

¹⁴⁷ See *supra* note 116 and accompanying text. Since an employee who controls the assets in his or her account is not a fiduciary, the duty of prudence and the associated requirement of diversification do not apply. See *supra* note 136.

¹⁴⁸ Cf. *Marshall*, 507 F. Supp. at 384 (holding that subjecting 23% of plan assets to single loan created too large a risk of loss).

¹⁴⁹ See *Beyond First Executive*, PENSIONS & INVESTMENTS, April 29, 1991, at 12, 12 [hereinafter *Beyond First*] (noting that when employer securities are investment option, employees normally invest between 20% and 50% of their account assets in stock).

¹⁵⁰ See *supra* note 35.

¹⁵¹ See *supra* note 38 and accompanying text.

PBGC coverage,¹⁵² while a defined-contribution plan beneficiary in a similar circumstance would not. It is submitted that requiring some minimum level of insurance for defined-contribution plans, such as insuring a percentage of account principal, would better protect the participants and beneficiaries of these plans.¹⁵³ Two important considerations must be addressed in order for this insurance to be provided. First, in order to have sufficient funds to guarantee these plans, PBGC funding would have to be increased,¹⁵⁴ probably by assessing a premium on defined-contribution plans. Such a premium, however, might also create a disincentive for instituting defined-contribution plans and reduce overall pension coverage. Second, insuring the principal might encourage speculative investing by employees who are not risk-averse, and could result in multiple payouts if employees repeatedly lost principal in high risk investments. Some type of minimum diversification, as discussed above, would probably be a sufficient deterrent to prevent these effects.

Educating participants in defined-contribution plans may help provide the security that retirement funds require. The Securities and Exchange Commission has proposed new disclosure requirements that mirror those of the Securities Exchange Act of 1933 by requiring employers to provide investment prospectuses and shareholder reports to plan participants.¹⁵⁵ But to some extent, increased disclosure was a part of the new section 404(c) regulations,¹⁵⁶ and questions have been raised about the effectiveness of this type of disclosure.¹⁵⁷

¹⁵² See generally 29 U.S.C. §§ 1301-1461 (1988 & Supp. 1992) (establishing parameters of ERISA plan termination insurance).

¹⁵³ See *Beyond First*, *supra* note 149, at 12 (noting that Xerox Corp., in recognition of this risk, recently revised its defined-contribution program to guaranty minimum benefits).

¹⁵⁴ See SUBCOMM. ON OVERSIGHT, HOUSE COMMITTEE ON WAYS AND MEANS, 103d Cong., 1st Sess., REPORT ON REFORM OF THE FEDERAL GOVERNMENT'S PENSION BENEFIT GUARANTEE PROGRAM 18-19 (Comm. Print 1993) (noting that PBGC faces increasing deficit and may require additional premiums to remain solvent with respect to defined-benefit plans).

¹⁵⁵ See *Employees Lack Expertise Needed to Invest for Retirement, Beese Says*, 20 Pens. Rep. (BNA) 702 (Mar. 29, 1993) (stating that SEC will propose legislation mandating that employees be provided with investment prospectuses and shareholder reports to better educate employees and help employers avoid possible lawsuits (citing Securities and Exchange Commissioner J. Carter Beese)).

¹⁵⁶ See *supra* note 130 and accompanying text.

¹⁵⁷ See Julie Rohrer, *The SEC Means Well, But . . .*, INSTITUTIONAL INVESTOR, Aug. 1992, at 117 (questioning need to replace prospectuses already being provided by banks and insurers with those required by SEC).

Pension simplification may be an alternative answer, and several legislative attempts have in fact been submitted to streamline the mass of regulations involving employee benefit plans. To be effective in simplifying the use of defined-benefit plans, the proposals must provide the means to reduce the cost and complexity of sponsoring these plans,¹⁵⁸ and probably would need to offer prospective participants new tax incentives for their use.¹⁵⁹ In past years a number of pension simplification bills have been introduced in Congress, some of which are still pending.¹⁶⁰

In some ways the private pension marketplace appears to be adapting to the shift to defined-contribution plans. Hybrid plans combining aspects of defined-benefit and defined-contribution plans have begun to appear in pension planning.¹⁶¹ One example is the cash balance plan, which establishes phantom accounts for each participant, though assets are actually pooled as in a defined-benefit plan. The phantom accounts are credited each year with a guaranteed return.¹⁶²

CONCLUSION

In 1974, Congress enacted ERISA in an effort to insure that employees retire with some measure of pension security. Since then, an unexpected shift in the private pension arena—the trend away from defined-benefit pension plans toward the increased use of defined-contribution plans—has put employees in a precarious

¹⁵⁸ See *Pension System Will Remain Healthy*, 7 Ben. Today (BNA) 260 (Aug. 10, 1990), available in LEXIS, Penben Library, Benday File (suggesting that companies avoid involvement in pensions, “‘not because they really don’t want to [be involved], but simply because it’s too complicated to comply and too complicated to understand’” (quoting Howard Weizman, executive director of Ass’n of Private Pension & Welfare Plans)).

¹⁵⁹ See generally Mark Fortune, *A Doomed Effort*, INSTITUTIONAL INVESTOR, Dec. 1991, at 165 (noting that no existing pension simplification proposal contains tax incentives to start new plans; therefore, these proposals have not been well received by small business community).

¹⁶⁰ See, e.g., H.R. 2641, 102d Cong., 2d Sess. (1992) (Employee Benefits Simplification Act); H.R. S. 762, 103d Cong., 1st Sess. (1993) (Pension Simplification Act).

¹⁶¹ See Fran Hawthorne, *Why Designer Pensions are in Fashion*, INSTITUTIONAL INVESTOR, June 1992, at 123 (noting “astounding” growth of hybrid plans that combine aspects of defined-benefit and defined-contribution plans, including cash-balance plans, age-weighted profit-sharing plans, target benefit plans, floor-offset plans, and other variations).

¹⁶² *Id.* at 124. The goals of cash balance plans include evening “out the accrual of benefits so that more money can be directed toward younger or short-term workers who move on long before retirement and to make the benefits comprehensible to plan participants.” *Id.*

position once again. Accompanying this change in pension plan availability is a shift in the risk of investing retirement funds. Employers, who bear the risks of poor investments when promising a retirement benefit, have little or no risk when employees self-direct their funds in a defined-contribution plan. Also, in defined-contribution plans, employees do not enjoy the advantages of professional investment management or PBGC insurance of their pension funds, but the employee may benefit from the greater portability of defined-contribution plans. The trend toward defined-contribution plans is a result of many causes, including frequent regulatory changes, cost differentials between plan types, and increased mobility in the workforce. It is unlikely, therefore, that any one action can completely reverse the trend currently taking place in the market. Steps can be taken, however, to insure that adequate retirement funds are available for future retirees, and hopefully a new pension crisis can be avoided.

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